FITCH RATES HAWAII'S $619.4MM TAX-EXEMPT, TAXABLE, & RFDG GOS 'AA'

Fitch Ratings-New York-11 September 2008: Fitch Ratings has assigned an 'AA' rating to the State of Hawaii's approximately:

--$300 million general obligation (GO) bonds of 2008, tax-exempt series DN;
--$293.4 million GO refunding bonds of 2008, series DO;
--$26 million GO bonds of 2008, taxable series DP.

The bonds are expected Sept. 23 through negotiation. In addition, Fitch affirms the 'AA' rating on Hawaii's approximately $4.4 billion outstanding GO bonds. The Rating Outlook is Stable.

The state of Hawaii's 'AA' rating is based on sound financial operations that have been maintained under stressful periods. Although the current biennial budget draws down fund balances, which were built-up over the last several fiscal years, the state forecasts modest increases in its emergency reserve fund. Hawaii has a highly developed tourist economy, with extensive infrastructure and all-season attraction, supplemented by the presence of second homes and timeshares. However, the sector's outsized presence and volatility is an exposure to the state's overall financial position. After strong recovery following the events of Sept. 11, 2001, which had a severe impact on this airline-dependent state, the state experienced a stark contraction in domestic visitor arrivals during the second quarter of 2008, following the loss of two passenger air carriers; annual visitor arrivals remain above the previous peak in 2000. The large military presence continues to be an important stabilizing factor, and notable employment growth in professional, educational, and health services in recent years added a measure of diversification.

Hawaii's tourist industry relies heavily on California and Japan, although there has been increased visitation from other countries, most recently Canada. Following a weak period in the early- to mid-1990s caused by recessions in Japan and California and the sharp drop in 2001, the tourism sector saw strong growth that began in 2004 and continued to a record high in 2006, due in part to gains in domestic arrivals. Visitor arrivals experienced only a marginal decline in 2007. The hotel occupancy rate was a strong 75.3% in 2007, albeit down from the 79.8% in 2006, reflective somewhat of the rising use of timeshares and hotel capacity expansion. The loss of two passenger air carriers earlier in 2008, combined with rising fuel costs and weakening consumer spending, have played negatively on Hawaii's tourism industry more recently. Through June 2008, visitor arrivals by air were down 5% from levels one year ago. While tourism remains dominant, the share of total employment in direct leisure and hospitality has dropped slightly since a decade ago, due to growth in service sector shares, which are approaching U.S. levels.

Following several years of strong gains, total employment growth decelerated in 2007, with the annual 1.1% growth rate matching that of the U.S. Job growth was up 0.1% in July 2008 over a year ago, compared to the U.S. contraction of 0.1% over the same period. Service sector job growth was healthy in July 2008, but jobs fell 1.3% in the leisure and hospitality sector. Unemployment rose to 3.8% in July, still well below the U.S. rate of 5.7%. Personal income growth has outpaced the nation for the past six years and estimated 2007 per capita personal income now stands at 101.6% of the U.S., ranking Hawaii 18th among the states by this measure.

Financial operations improved following a difficult period in fiscals 2001-2003 when revenues fell short and fund balances were reduced. With strong revenue growth, the state finished fiscal 2006 with combined general and reserve fund balances of $785.8 million or 15.9% of total general fund resources. The reserve fund accounted for $53.5 million of the total. More modest revenue growth occurred in fiscal 2007, before revenue performance began to weaken during the course of fiscal 2008 and finished just 1.2% over fiscal 2007. At the governor's request, the state's revenue estimating council met recently, outside of its normal quarterly review, and reconsidered revenue expectations for fiscal 2009, the second year of the current biennium, as well as for fiscals 2010 and

2011. Recognizing current economic concerns and the modest tax growth in fiscal 2008, the revised estimates forecast just 1% revenue growth in fiscal 2009 and opened an estimated $900 million gap over the next three fiscal years. The state has since been developing a rebalancing plan which cuts spending, shifts from pay-as-you-go capital spending and restructures debt, and redirects funds from various non-general fund accounts. A budgeted general fund drawdown still occurs; however, the state expects to increase its reserve fund to $86 million and not use a separate hurricane relief fund for budget balance. Combined general and reserve fund balances of $140.5 million, or 2.7% of estimated revenues, are anticipated at fiscal 2009 close. Revenue estimates will be revisited as the state prepares for the next biennium.

Hawaii's government is highly centralized, and the state is responsible for many functions, such as education, normally handled at the local level. As a result of this structure, debt is and will remain high although it is scheduled for prompt retirement, with over 70% of bonds due in 10 years. Including this issue, net tax-supported debt equates to $3,712 per capita and 9.5% of personal income. Funding levels for Hawaii's pension system remain a concern having declined from 95% in 2000 to 67.5% as of June 30, 2007, with the unfunded liability exceeding $5 billion. The system's funding level is a bit improved from a year ago, reflecting improved investment returns as well as state funding efforts and reforms.

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Note: Fitch issued an exposure draft on July 31 proposing a recalibration of tax-supported and water/sewer revenue bond ratings which, if adopted, may result in an upward revision of this rating (see Fitch research 'Exposure Draft: Reassessment of the Municipal Ratings Framework').

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